

November 25, 2002

To: Supervisor Zev Yaroslavsky, Chairman
Supervisor Gloria Molina
Supervisor Yvonne Brathwaite Burke
Supervisor Don Knabe
Supervisor Michael D. Antonovich

From: David E. Janssen
Chief Administrative Officer

STATE BUDGET UPDATE

Governor Calls Special Session for December 9, 2002

Faced with a two-year budget shortfall estimated at \$21 billion by the Legislative Analyst, Governor Davis last Thursday, November 21, 2002, called the Legislature into an unusual December special session. In announcing the special session after a conference call with the legislative leadership, Davis stated: "This problem is so big it behooves all of us to set aside our ideological preconceptions and come together in a bipartisan fashion to address this shortfall." The session is expected to be a short one - perhaps two to three days.

In making the announcement, the Governor provided few details beyond saying that he would propose a combination of program cuts and other measures to reduce spending in the current budget by \$5 billion. The package will not include tax or fee increases. The Governor has scheduled a meeting with the leadership on December 3, 2002, at which he will probably present his proposal.

Speculation began almost immediately regarding what was likely to be in his proposal. Because of the fact that revenues in the current year have fallen far short of projections, the State could reduce Proposition 98 funding for schools by \$1.9 billion without violating the constitutional guarantee. Leaders in the education community have indicated that the Administration has told them it will propose this reduction and has asked for their suggestions on how best to accomplish it.

The other main topic of speculation is the VLF. Depending on how one frames the issue, the VLF can be portrayed as a spending reduction or a tax increase or both. Under current law, if the State reduces or eliminates the VLF backfill that local governments currently receive to compensate them for the rate reduction, the VLF rate will automatically increase to prevent any loss of funds to local governments. In a technical, budget sense, this would be a budget reduction. And while the reduction would result in a tax increase, the increase is provided for in current law and is arguably not a new tax increase. In short, despite the Governor's statement that his proposal would not include tax or fee increases, it is quite possible that the VLF will be taken up in the special session. Because a majority of the Legislature can approve such an action, making Republican votes unnecessary, it is almost certain to happen at some point. Each month of delay costs the State around \$330 million. While ideally a VLF increase should take effect with January 2003 bills, those bills have already been mailed. Moreover, if the VLF backfill reduction is approved by less than a two-thirds majority, which is likely, it could not take effect until 90 days after the close of the session.

While there has been virtually no speculation about possible cuts to counties, it is worth recalling that the Governor proposed about \$2 billion in cuts to counties in the current budget. The Legislature restored almost half of those cuts and even after the Governor's line item vetoes, cuts to counties totaled roughly \$1.1 billion. Consequently, it is likely the Governor will revive many of his unsuccessful or partially successful proposals from last year, especially the reductions in administrative reimbursement for Medi-Cal, Food Stamps and CalWORKs. In addition, county payment of the Federal child support penalty is likely to be proposed again, if not in December, than in the January budget.

Finally, as if things weren't bad enough, the Administration indicated that the size of the budget shortfall is likely to be larger than the \$21 billion forecast by the Legislative Analyst. Senator Burton has suggested \$25 billion but others have speculated as high as \$30 billion. Whatever the eventual number, it will have catastrophic impacts on a general fund budget of \$75 billion.

We will keep you advised of any new developments.

DEJ:GK
MAL:JR:ib

Each Supervisor
November 25, 2002
Page 3

c: Executive Officer, Board of Supervisors
 County Counsel
 Local 660
 All Department Heads
 Legislative Strategist
 Coalition of County Unions
 California Contract Cities Association
 Independent Cities Association
 League of California Cities
 City Managers Associations
 Buddy Program Participants